

Sales - Unconscionable Contract or Clause - Uniform Commercial Code

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SALES—UNCONSCIONABLE CONTRACT OR CLAUSE— UNIFORM COMMERCIAL CODE

Defendant, in 1962, purchased certain household items from the plaintiff pursuant to a standardized form contract. Included in this contract was the provision that as long as any unpaid balance remained on this merchandise, plaintiff retained the right to repossess items previously purchased, even though they had been paid for in full. Upon default, plaintiff brought proceedings against defendant-vendee, relying upon this contractual device to repossess merchandise purchased as early as 1957. Judgment was entered for plaintiff in the trial court, and this holding was affirmed in the intermediate court of review. On appeal to the United States Court of Appeals for the District of Columbia, the case was remanded for consideration of whether the contract was unenforceable by virtue of its alleged unconscionable character. *Williams v. Walter-Thomas Furniture Company*, 350 F.2d 445 (D.C.Cir. 1965).

In basing its decision upon the doctrine of unconscionability, the Court of Appeals cited as authority section 2-302¹ of the *Uniform Commercial Code*, even though the *Code* had not been adopted in the District of Columbia at the time the contract was made. The purpose of this case note is to examine the doctrine of unconscionability in terms of both theory and application. In the scope of this analysis, it will become evident to the reader that section 2-302 merely codifies a legal and equitable defense which has evolved from the common law.

Though the right to contract freely has been referred to as the inevitable counterpart of a free enterprise system,"² its exercise has not always led to just and equitable results, in spite of the assumption that each party is best able to provide for his own interest. At an earlier date in England, the law courts, when dealing with unfair sales contracts, arrived at an equitable result by refusing to enforce the unjust contractual provision freely "bargained for."³ A similar result was reached on this

¹ UNIFORM COMMERCIAL CODE § 2-302 (1962). "(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result. (2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination."

² Kessler, *Contracts of Adhesion—Some Thoughts about Freedom of Contract*, 43 COLUM. L. REV. 629, 630 (1943). See also, Williston, *Freedom of Contract*, 6 CORNELL L.Q. 365 (1921).

³ In *James v. Morgan*, 83 Eng. Rep. 323 (1664), the action was in assumpsit to pay for a horse at the rate of a barley corn per nail, doubling it every nail. There were 32 nails in the shoes of the horse, bringing the price of the horse to 500 quarters of

side of the Atlantic, where it has been held that if an agreement is unreasonable and unconscionable, although not void for fraud, a court of law will give the party who sues for its breach damages, not according to its letter, but only that to which he is equitably entitled.⁴ Conversely, other cases have held that in the absence of fraud or oppression the courts are not interested in the unreasonableness of contracts voluntarily entered into between parties *compos mentis* and *sui juris*.⁵

In contrast to the dichotomy of opinion in law courts, Equity courts will refuse to specifically enforce a contract if there will be an unconscionable result.⁶ The bases upon which Equity courts have refused to enforce a contract for unconscionability have been diverse.⁷ This can be explained by the fact that no practical definition of unconscionability has been forthcoming, although it has been attempted.⁸

barley. The court directed the jury to discard the terms agreed upon and give the plaintiff the value of the horse which was 8 pounds in damages. In *Thornborough v. Whiteacre*, 2 Ld. Raym. 1164, 92 Eng. Rep. 270 (1706), plaintiff declared that the defendant in consideration of 2s. 6d. paid down and 4 pounds, 17 s. 6 d. to be paid on performance of the agreement promised to give plaintiff 2 grains of rye on a certain Monday and doubling it successfully on every Monday for a year. The total amount of rye would have amounted to 524,288,000 quarters. The court held that if a man undertake for valuable consideration to do what is impossible, an action will lie against him for non-performance. However, the court recognized the case of *James v. Morgan* as good law and said though the contract was a foolish one, the defendant ought to pay something for his "folly." The parties settled for a half-crown and costs and no judgment was given. See generally the discussion of English authorities in *Hume v. United States*, 132 U.S. 406 (1889).

⁴ *Hume v. United States*, *supra* note 3; *Scott v. United States*, 79 U.S. 443 (1870); *Schnell v. Nell*, 17 Ind. 29 (1861); *Baxter v. Wales*, 12 Mass. 365 (1815); *Leland v. Stone*, 10 Mass. 459 (1813); *Luing v. Petersen*, 143 Minn. 6, 172 N.W. 692 (1919); *Greer v. Tweed*, 13 Abb. Pr. (n.s.) 427 (N.Y. 1872).

⁵ See *Florida Sportservice Inc. v. Miami*, 121 So. 2d 450 (Fla. 1960); *Brewington v. Loughran*, 183 N.C. 558, 112 S.E. 257 (1923); *Findlayson v. Findlayson*, 17 Or. 347, 21 Pac. 57 (1889).

⁶ *Campbell Soup Co. v. Wentz*, 172 F.2d 80 (3rd Cir. 1948); *Indianapolis Morris Plan Corp. v. Sparks*, 132 Ind. App. 145, 172 N.E.2d 899 (1961); *Heningsen v. Bloomfield Motors, Inc.*, 32 N.J. 352, 161 A.2d 69 (1960). See generally, 4 POMEROY, EQUITY JURISPRUDENCE § 1405 (a) (5th ed. 1941).

⁷ 4 POMEROY, *supra* note 6 at 1043, wherein it is said, "[t]he contract must be perfectly fair, equal, and just in its terms and in its circumstances: If then, the contract itself is unfair, one sided, unjust, unconscionable, or affected by any other inequitable feature; or if its enforcement would be oppressive or hard on the defendant, or would prevent his enjoyment of his own rights, or would work injustice; or if the plaintiff has obtained it by sharp and unscrupulous practices, by over-reading, by trickery, by taking undue advantage of his position, by non-disclosure of material facts, or by any other unconscionable means, then specific performance will be refused."

⁸ The most common definition of an unconscionable contract or agreement is "one which no man in his senses, not under delusion, would make on the one hand, and which no fair and honest man would make on the other." BLACK, LAW DICTIONARY (4th ed. 1951).

Notwithstanding the lack of any well formulated common-law rule denying remedies which impose undue hardships, the fluidity of the concepts of offer, acceptance, consideration, fraud, duress, misrepresentation, and so forth, has enabled courts to avoid the enforcement of unconscionable contracts. The manipulation of these concepts has led to justifiable criticism, in that it has resulted in leaving "twisted law on the books to perplex and mislead lawyers and judges considering cases in which the concept of unconscionability is not present".⁹ According to Professor Hawkland, section 2-302 was included in the *Uniform Commercial Code* to enable courts of law to pass directly upon the question of unconscionability instead of "bastardizing" legal concepts or adversely construing the language in the contract.¹⁰

Although the *Uniform Commercial Code* does not contain a definition of unconscionability, the official comments of the commissioners are helpful in this regard. In the 1949 draft, the comments indicate that the "section is intended to apply to the field of sales the Equity court's ancient policy of policing contracts for unconscionability and unreasonableness".¹¹ The present comments are similar in that they state the section

is intended to make it possible for the courts to police explicitly against the contracts . . . they find to be unconscionable . . . the principle is one of the prevention of oppression and unfair surprise . . . and not disturbance of allocations of risks based on superior bargaining power.¹²

The problem of unfair surprise has arisen most often in the application of rules of assent to form contracts, whereas, examples of oppression have arisen in cases of unequal bargaining power in diverse fact situations.¹³ The standard of oppression and unfair surprise is the basis of what is to be considered unconscionable. However, the commercial setting and surrounding circumstances are additional factors which the court should take into consideration. This freedom of interpretation has been criticized by those who allege that it would "stir up" litigation and increase uncertainty in court decisions,¹⁴ in addition to breaching the maxim that

⁹ HAWKLAND, *SALES AND BULK SALES* 27 (4th ed. 1958).

¹⁰ HAWKLAND, *Major Changes Under the Uniform Commercial Code In Sales Contracts*, 10 PRACT. LAW. 73, 90 (1964); UNIFORM COMMERCIAL CODE § 2-302, comments (1962).

¹¹ UNIFORM COMMERCIAL CODE § 2-302, comments (1949).

¹² UNIFORM COMMERCIAL CODE § 2-302, comments (1962).

¹³ For a more complete discussion of the implication of oppression and unfair surprise, see 45 VA. L. REV. 583 (1959).

¹⁴ Note, 18 U. CHI. L. REV. 146, 152 (1950).

courts should not endeavor to make contracts for the parties.¹⁵ As a result of such criticism, it has been suggested that the section on unconscionability be omitted altogether from the Code.¹⁶ Though the *Uniform Commercial Code* has been adopted in forty-four jurisdictions,¹⁷ both California and North Carolina have omitted section 2-302 entirely.¹⁸ Despite this criticism, the court's freedom of discretion on the question of unconscionability would seem to be its prime asset, since the factual situations surrounding different contracts are considerably diverse, and a strict definition would hinder rather than assist reaching an equitable and just result.

Where a contract or clause is declared unconscionable, section 2-302 further provides that the court may refuse to enforce the contract, or enforce the remainder of the contract without the unconscionable clause, or limit application of any unconscionable clause so as to avoid any unconscionable result.¹⁹ Since the court can eliminate certain clauses from the contract on the basis of unconscionability and enforce the remainder, the question arises as to what happens to the party who at the time of the contract intended the unconscionable clause or clauses to be an integral part of the contract. Is he to be bound to the remainder of the contract to his manifest intention? The *Code* appears to answer this question in the affirmative. As a safeguard against such a result, it has been suggested that the parties include a provision in the contract stating whether or not the entire contract should stand if any particular clause or clauses are later held to be unconscionable.²⁰ Even though such a clause would not be binding on the court, it would, no doubt, influence the court's decision by manifesting the intent of the parties as to the matter of unconscionability.²¹

Where it is likely that the contract or clause will be held unconscionable, section 2-302(2) provides that "the parties shall be afforded a reason-

¹⁵ Note, 33 ORE. L. REV. 113, 115 (1954).

¹⁶ *Ibid.* at 116.

¹⁷ In the following jurisdictions, the *Code* has been adopted and is presently in effect: Alaska, Arkansas, California, Connecticut, District of Columbia, Georgia, Illinois, Indiana, Kansas, Kentucky, Maine, Maryland, Massachusetts, Michigan, Missouri, Montana, Nebraska, New Hampshire, New Jersey, New Mexico, New York, Ohio, Oklahoma, Oregon, Pennsylvania, Rhode Island, Tennessee, Utah, Virgin Islands, Virginia, West Virginia, Wisconsin, Wyoming. In the remainder of the jurisdictions, the *Code* has been adopted but will not become effective until the indicated dates: Alabama (Jan. 1, 1967), Colorado (Sept. 1, 1966), Florida (Jan. 1, 1967), Hawaii (Jan. 1, 1967), Iowa (Sept. 4, 1966), Minnesota (Sept. 1, 1966), Nevada (March 1, 1967), North Carolina (Sept. 1, 1967), North Dakota (Sept. 1, 1966), Texas (Sept. 1, 1966), Washington (Sept. 1, 1967). UNIFORM LAWS ANNOTATED, UNIFORM COMMERCIAL CODE § 2-302 (1965 supp.).

¹⁸ *Ibid.*

¹⁹ UNIFORM COMMERCIAL CODE § 2-302(1) (1962).

²⁰ 1 ANDERSON, UNIFORM COMMERCIAL CODE § 2-302:2 (1961).

²¹ *Ibid.*

able opportunity to present evidence as to its commercial setting, purpose and effect to aid the court in making the determination.”²² This feature of the *Code* is new, and its importance lies in the fact that it provides an opportunity for the adverse party to present evidence of the surrounding circumstances and commercial setting. This is a matter of right, and not subject to limitation by the court.²³ It would seem that this provision, which is partly procedural and partly substantive, protects the adverse party from being surprised by the issue of unconscionability where his opponent did not allege it in his pleadings, but rather the court first raised the issue of its own discretion. It should be recognized, however, that once the evidence is introduced, the court, and not the jury, is the ultimate arbiter of this issue.²⁴

Turning now to the matter of form contracts, it was noted earlier that contracts of this type are more susceptible of being held unconscionable, since they are more likely to be oppressive. This is understandable, since the party printing such a contract would be more likely to include terms favorable to himself rather than the other contracting party. Despite this obvious advantage, standardized form contracts were created as a matter of practical necessity:

the development of large scale enterprise with its mass production and distribution made a new type of contract inevitable—the Standardized Mass Contract. A standardized contract, once its contents have been formulated by a business firm, is used in every bargain dealing with the same product or service. The individuality of the parties which so frequently gave color to the old type of contract has disappeared.²⁵

Consequently, the average individual who becomes a party to a form contract usually agrees to a type of transaction in which only such matters as price, quantity and quality are of interest. The remaining set of collateral form provisions used to limit risk and promote certainty are seldom given attention and it is through these terms that unfair advantage is derived.²⁶ Professor Llewellyn contended that where form contracts are printed by one side, the courts should recognize that what is in print does not necessarily represent the true bargain. In his opinion, judges should be able

to see that a free contract presupposes a free bargain, and that a free bargain presupposes free bargaining, and that where bargaining is absent in fact, the conditions and clauses to be read into the bargain are not those which happen

²² UNIFORM COMMERCIAL CODE § 2-302(2) (1962).

²³ 1 ANDERSON, UNIFORM COMMERCIAL CODE, *supra* note 20 at § 2-302:5.

²⁴ UNIFORM COMMERCIAL CODE § 2-302(2), comments (1962).

²⁵ Kessler, *supra* note 2 at 631.

²⁶ 18 U. CHI. L. REV., *supra* note 14. See generally, Note, 63 HARV. L. REV. 494 (1950), for a more thorough discussion of printed form contracts.

to be printed on the unread paper, but are those which a sane man might reasonably expect to find on that paper. The background of trade practices give a first indication; the line of authority rejecting unreasonable practice offers the needed corrective. The distinction involved, even when applied to the testing of a standardized printing, is a simple one, and one which responds rather readily to the trained intuition of a case law judge for what is too unfair.²⁷

At a later date, Llewellyn felt that in the area of sales law, the *Uniform Commercial Code* would assist judges considerably in avoiding enforcement of those not-bargained-for provisions through the "good faith" provisions contained therein.²⁸ It was his belief that:

these provisions may lead appellate courts into a machinery for striking down where striking down is needed, without getting in the way of reasonable construction of the reasonable, and without need for wholly upsetting the deal in order to escape a particular obnoxious result.²⁹

Even though this effective tool has been put into the hands of the law courts, there has not been any great occasion to use it, as evidenced by the sparseness of cases decided under this section or referring to it as "good law."

Considering now the matter of judicial interpretation of section 2-302, at this date only six decisions may be found which provide persuasive authority in the avoidance of unconscionable contracts. In three of these cases, however, the *Code* had not been adopted at the time the contracts were made, but this did not deter the courts from relying thereon.

In those cases where the *Uniform Commercial Code* had been adopted prior to the contracting date, the courts did not rely solely upon section 2-302 as the basis for their decision. In *American Home Improvement Inc. v. MacIver*,³⁰ the defendant contracted with a home improvement company and signed a financing agreement which, in violation of a New Hampshire statute, did not disclose the interest rate or other fees. Defendant breached the contract upon realizing that he would be forced to pay \$2,568.00 for material and labor which originally was estimated at \$1,759.00. In denying recovery to the plaintiff, the court held that the purpose of the disclosure statute would be implemented, and, in addition, offered section 2-302 as an alternative argument. The court was influenced by the fact that plaintiff's performance had been negligible, and noted

²⁷ Llewellyn, Book Review, 52 HARV. L. REV. 700, 704 (1939).

²⁸ UNIFORM COMMERCIAL CODE §§ 1-203, 2-301(1)(b) and 2-302 (1962). Section 1-203 provides that "every contract of duty within this Act imposes an obligation of good faith in its performance or enforcement." Section 2-103(1)(b) states that "good faith in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade."

²⁹ LLEWELLYN, THE COMMON LAW TRADITION, 362, 369 (1960).

³⁰ 105 N.H. 435, 201 A.2d. 886 (1964).

that if enforcement was granted, defendant would be required to pay \$1,609.00 over and above the fair cost.

The case of *In Re Elkins-Dell Mfg. Co. Inc.*³¹ involved the matter of secured transactions, covered by article 9 of the *Code*. The creditor had advanced 75% of the accounts receivable in return for a security interest therein, in addition to other assets being pledged by the debtor. Among other provisions, the contract stated that the debtor was prohibited from selling or assigning accounts to anyone other than the creditor, but the creditor was not obligated to buy any accounts. The debtor was prohibited from borrowing from anyone other than the creditor without the creditor's permission, and the creditor had the unilateral right to change terms of the contract upon certified mail notice to the debtor. In refusing to enforce the contract, the court held that the doctrine of unconscionability was applicable to article 9 as well as to article 2. Since section 1-102(3) imposes a general obligation of good faith upon the parties, it was reasoned that the "unconscionability" features of section 2-302 should be incorporated by reference into the basic underlying philosophy expressed in section 1-102."

The same rationale was applied in the case of *In Re Dorset Steel Equipment Co., Inc.*³² wherein a security agreement was entered into whereby the creditor advanced certain sums to a partnership. Although the transaction was secured by the assignment of accounts receivable, the obligor was required to incorporate in order that the creditor might exact interest of approximately 18% per annum. Other unconscionable features were contained in the agreement as well. The court held that a contract of this nature would not be recognized as a valid claim against the bankrupt and referred to section 2-302.

As noted earlier, even where the *Code* was not yet in force at the time of contracting, the courts have turned to section 2-302. In *Quality Finance Co. v. Hurley*,³³ the court used this section in determining the validity of a waiver of defenses by a vendee as against the vendor's assignee. In *Heningsen v. Bloomfield Motors Inc.*,³⁴ the court held that a disclaimer of all other express or implied warranties, except replacement of defective parts in a contract for the sale of a new automobile, was "violative of public policy and void."³⁵

³¹ 2 UNIFORM COMMERCIAL CODE REPORTING SERVICE 1021 (U.S. Dist. Ct., ED. Pa., Bankruptcy no. 26109, 1965).

³² 2 UNIFORM COMMERCIAL CODE REPORTING SERVICE 1016 (U.S. Dist. Ct., ED. Pa., Bankruptcy no. 26532, 1965).

³³ 337 Mass. 150, 148 N.E.2d 385 (1958).

³⁴ 32 N.J. 358, 161A.2d 69 (1960).

³⁵ *Id.* at 408, 161 A.2d at 97.

The case at bar likewise falls into this category. Here, the court took cognizance of the fact that

Congress has recently enacted the Uniform Commercial Code, which specifically provides that the court may refuse to enforce a contract which it finds to be unconscionable at the time it was made. . . . The enactment of this section, which occurred subsequent to the contracts here in suit, does not mean that the common law of the District of Columbia was otherwise at the time of enactment, nor does it preclude the court from adopting a similar rule in the exercise of its powers to develop the common law for the District of Columbia.³⁶

Thus, the true import of the instant case is readily ascertained by the language of the court. From this decision, it is evident that, even in the absence of section 2-302, the common law of the District of Columbia had the inherent means effectively to cope with the problem of unconscionable contracts.

In conclusion, although it is difficult to predict any specific trend from either *Walker* or those cases which have considered section 2-302, it appears that its application will not be limited merely to standardized form contracts or to contracts for the sale of goods. In the past, both judges and chancellors have granted relief from the oppressive features of grossly unfair contracts, and there is no logical reason why they should not continue to do so. The presence of section 2-302 will serve to provide additional impetus in this regard, and thus aid the courts in dealing with this problem. It is submitted, however, that though an effective tool has been placed at the court's disposal, caution should be exercised in its use. Contracts should be held intact where the intent of the parties clearly manifests a desire to enter into such an agreement. To declare an entire contract unenforceable due to one insignificant unconscionable clause is certainly as unjust and inequitable as permitting enforceability of that single clause.

Peter Apostol

³⁶ *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445, 449 (D.C. Cir. 1965).

TORTS—CHARITABLE HOSPITAL IMMUNITY— A MODIFIED DOCTRINE ABROGATED

The plaintiff, Clarence Lee Adkins, brought action against the defendant hospital to recover damages for personal injuries inflicted upon him while he was a paying patient¹ in the hospital. The injuries sustained consisted of severe burns resulting from plaintiff's fall against a hot,

¹ Affidavits were presented to the court stating that the defendant hospital refused to admit the plaintiff until assurance was given that the bill for his care would be paid.